Competitive Equilibria with Asymmetric Information*

Alberto Bisin
NYU

Piero Gottardi
Universita' di Venezia

First version: January 1997; this version: November 1998

Abstract

This paper studies competitive equilibria in economies where agents trade in markets for standardized, non-exclusive financial contracts, under conditions of asymmetric information (both of the moral hazard and the adverse selection type). The problems for the existence of competitive equilibria in this framework are identified, and shown to be essentially the same under different forms of asymmetric information. We then show that a 'minimal' form of non-linearity of prices (a bid-ask spread, requiring only the possibility to separate buyers and sellers), and the condition that the aggregate return on the individual positions in each contract can be perfectly hedged in the existing markets, ensure the existence of competitive

*We are grateful to A. Banerjee, L. Blume, D. Easley, D. Gale, R. Guesnerie, O. Hart, M. Hellwig, T. Hens, B. Holmstrom, M. Magill, A. Mas-Colell, E. Maskin, H. Polemarchakis, M. Quinzii, K. Shell, P. Siconolfi, R. Townsend, C. Wilson and in particular to J. Geanakoplos for very useful conversations and comments. The project of this paper was begun when the first author was at MIT and the second was visiting Harvard University, and it continued while the first author was visiting Delta; we wish to thank the three institutions which provided us with very stimulating intellectual environments. Earlier versions of the paper have been presented at SITE '96, '97, the ET Conference in Antalya, the NBER Conference on Economic Theory at Yale, the Summer Symposium in Financial Economics in Gerzensee, the Winter Meetings of the Econometric Society in Chicago, and seminars at Cornell, Harvard, MIT, NYU, Princeton, Chicago, Minnesota, Penn, Cambridge, LSE, Paris, UPF, UCL; we are grateful to participants for helpful comments. The financial and institutional support of the C.V. Starr Center for Applied Economics is gratefully acknowledged. The second author is also grateful to CNR and MURST for financial support.